



MEMORANDUM FOR Secretaries of the Military Departments
Director of Defense Research and Engineering
Assistant Secretary of Defense (Comptroller)
Assistant Secretary of Defense (I&L)
Assistant Secretary of Defense (SA)
Director, Defense Supply Agency
Director, Defense Contract Audit Agency

SUBJECT: Cost Growth Definition

Attached is a definition of the term cost growth and the elements which must be identified to explain cost growth. It has been prepared by a task force, mentioned in my memorandum of August 13, 1969, Subject: Selected Acquisition Reports/Program Status Reports, for universal use throughout the Department of Defense in reports and other communications.

The term "cost overrun" has been used by many people both within the Government and outside, to refer to varying circumstances wherein some amount of actual or estimated expenditure exceeded some stated or other estimated amount. The variance of these circumstances cause the use of this term to create confusion in the minds of many and to cast improper reflection on the true status of events.

In studying the problem in depth, the task force came to the realization that the term "cost overrun" as widely used suffered three fatal defects: (1) it had a very narrow technical meaning; (2) it was widely used in both Government and by the public as having a very much wider and hence imprecise meaning; (3) the set of circumstances embraced by the public use of the term were so wide and varied, that it was more practical to develop workable definitions of new terms than to persist in trying to perfect the meaning of "cost overrun." Thus, the Committee started with a general and imprecise term, "cost overrun," and discarded it as unworkable, and replaced it with the term "cost growth," including a structured set of definitions related to it, which are workable.

On file OSD release instructions apply.

I would like to have your views prior to taking further action to incorporate this set of terms in those Directives, Instructions and Regulations which require reporting of cost growth. When adopted, the often misunderstood term "cost overrun" will disappear from use within the Department.

A handwritten signature in dark ink, appearing to read "Dan Patrick". The signature is stylized with a large, looped initial "D" and a cursive "Patrick".

Attachment

29 October 1969

"Cost Growth"

Cost Growth is a term related to the net change of an estimated or actual amount over a base figure previously established. The base must be relateable to a program, project or contract and be clearly identified including source, approval authority, specific items included, specific assumptions made, date and amount. The events causing "Cost Growth" must then be explained by one or more of the following categories and the appropriate amount of each shown as "estimated" or "actual.":

1. System Performance Change - A change in the system performance requirement (e.g., speed, weight, reaction time, circular error probability, safety features, payload, frequency propagation, range, scan, etc.). Specific changes must be separately identified and quantified as to amount.
2. Engineering Change (Not Affecting Performance) - A change in configuration identification directed by the Government which does not change approved Performance requirements.
3. Quantity Change - A change in quantity to be procured at the original price after making appropriate and consistent adjustments for cost-quantity relationships (e.g., improvement curves).
4. Contract Added Support - A change in contract requirements to reflect support items (e.g., added spare parts, training, ancilliary equipment, warranty provisions, etc.) which were contemplated initially but not ordered or priced on contract initially.
5. Schedule Change - A change in an approved delivery schedule, completion date or intermediate milestone of development or production. Each change must separately be identified as Government responsibility or contractor responsibility and quantified as to amount.
6. Unpredictable Change - A change caused by Acts of God, work strikes, Federal or State law changes or other unforeseeable matters not related to any other category.

7. Economic Change - A change due to the operation of one or more factors of the economy other than that explained by Contractual Price Adjustment. Economic change specifically identifiable to the provisions of a contract evaluation clause must be separately identified.

8. Estimating Change - A change in program cost due to refinements of the base estimate. These include mathematical errors, omission of items, different assumptions used in estimating, changing the year of the constant dollars, etc. Specific estimating changes should be separately identified and quantified as to amount.

9. Contractual Price Adjustment - A change due to the contractor's actual or expected cost/schedule/performance being different than predicted as evidenced by contract target prices (FPI contracts), estimated cost and/or fee (cost reimburseable type contracts) or redeterminable prices (FPR contracts) after considering offsetting fee or profit adjustments, but excluding any of the changes previously mentioned. This also includes any changes in contract amount due to earned incentives and bonus payments under CPAF contracts.